

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
VOLT INFORMATION SCIENCES, INC.	:	:DETERMINATION
DTA NO. 802809	:	
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Fiscal Years	:	
Ended October 31, 1978 through October 31, 1981.	:	

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Petitioner, Volt Information Sciences, Inc., 101 Park Avenue, New York, New York 10178, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended October 31, 1978 through October 31, 1981.

A hearing was commenced before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on October 17, 1989 at 9:15 A.M. and concluded at the same offices on February 26, 1990 at 1:30 P.M., with all briefs to be submitted by March 15, 1991. Petitioner filed its briefs on July 9, 1990 and March 15, 1991. The Division of Taxation filed its brief on February 25, 1991. Petitioner appeared by Ernst and Young (Mervin Rosenblum, C.P.A.) at the hearing on October 17, 1989 and by Ernst and Young (Kenneth T. Zemsky, C.P.A.) at the hearing on February 26, 1990. The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

ISSUES

I. Whether it was proper for the Division of Taxation to require petitioner to add back to its entire net income both the income which it received from certain subsidiaries and also the interest expense indirectly attributable to subsidiary capital.

II. Whether the Division of Taxation improperly included interest expense from second-tier subsidiaries in its calculation of interest expense indirectly attributable to subsidiary capital.

III. Whether the Division of Taxation correctly determined separate values of subsidiary capital when it calculated the interest expense indirectly attributable to subsidiary capital and the tax on subsidiary capital.

IV. Whether the fact that different amounts were ascribed to advances in the calculation of interest expense indirectly attributable to subsidiary capital and loans in the calculation of the tax on subsidiary capital establishes an error in the calculation of the asserted deficiency of tax.

V. Whether petitioner has established that the Division of Taxation improperly included indebtedness, on which interest expense was deducted by the subsidiary under either Articles 9-A, 32 or 33 of the Tax Law, in petitioner's subsidiary capital.

VI. Whether the interest expense arising from the issuance of certain convertible debentures should be excluded from the Division of Taxation's calculation of interest expense indirectly attributable to subsidiary capital.

VII. Whether the audit workpapers and the Division of Taxation's testimony at the hearing demonstrate that the audit was unreliable.

#### FINDINGS OF FACT

During the period in issue, petitioner, Volt Information Sciences, Inc. ("Volt"), provided technical labor services, such as engineers, on a contract basis to various industries such as aerospace, aircraft and telecommunications. Volt also supplied temporary office labor to businesses. Another segment of Volt's business engaged in the manufacture of computerized photo typesetters. In addition, Volt produced technical publications.

Volt filed a State of New York Corporation Franchise Tax Report for each of the fiscal years in issue. To the extent relevant herein, these returns disclose the following:

(a) Volt's Corporation Franchise Tax Report for the fiscal year ended October 31, 1978 included a schedule C entitled "Subsidiary Capital and Allocation". The instructions on the report directed taxpayers to "[i]nclude all corporations, except a DISC, in which you own more than 50% of the voting stock." The following corporations, employer identification numbers and percentages of voting stock owned were reported:

<u>Corporation</u>	<u>Employer Ident. No.</u>	<u>Percentage of Voting Stock Owned</u>
Volt Tech. Corp.	95-2056687	100.0
Autologic Inc.	94-1595880	88.0
Comm Residential	52-0936321	100.0
Jefferson Adams	13-2719371	100.0
MKUK Games Corp.	13-2270143	100.0
Volt Tech. Corp.	75-1055081	100.0
Volt Temp. Serv.	13-2836154	100.0
Volt Tech. Serv.	13-2835773	100.0
Shaw & Shaw Inc.	94-2452403	100.0

Volt's New York franchise tax report included a copy of Volt's consolidated U.S.

Corporation Income Tax Return for the fiscal year ended October 31, 1978. Volt's Federal return included the following schedule of consolidated subsidiaries:

<u>Name</u>	<u>Employer Identification No.</u>
Volt Technical Corp. (DEL)	75-1055081
Volt Technical Corp. (CAL)	95-2056687
Autologic, Inc.	94-1595880
Community Residential Centers, Inc.	52-0936321
Jefferson-Adams Corporation	13-2719371
Volt Technical Services, Inc. (N.Y.)	13-5649428
MKUK Games Corporation	13-2770143
Volt Technical Services Corporation	13-2835773
Volt Temporary Services, Inc.	13-2836154
Shaw & Shaw, Inc.	94-2452403

(b) Volt's State of New York Corporation Franchise Tax Report for the fiscal year ended October 31, 1979 calculated its tax as the sum of allocated net income plus allocated subsidiary capital. The report included a schedule C which listed the following corporations in which it owned more than 50% of the voting stock. The corporations, employer identification numbers and percentages of voting stock were reported as follows:

<u>Corporation</u>	<u>Employer Ident. No.</u>	<u>Percentage of Voting Stock Owned</u>
Volt Tech. Corp.	95-2056687	100.0
Autologic Inc.	94-1595880	88.0
Comm Residential	52-0936321	100.0
Jefferson Adams	13-2719371	100.0
MKUK Games Corp.	13-2270143	100.0
Volt Tech. Corp.	75-1055081	100.0
Volt Temp. Serv.	13-2836154	100.0

Volt Tech. Serv.	13-2835773	100.0
Shaw & Shaw Inc.	94-2452403	100.0

Volt's New York Corporation Franchise Tax Report included a copy of Volt's consolidated U.S. Corporation Income Tax Return for the fiscal year ended October 31, 1978.

Volt's Federal return included the following schedule of consolidated subsidiaries:

<u>Name</u>	<u>Employer Identification No.</u>
Volt Technical Corp. (DEL)	75-1055081
Volt Technical Corp. (CAL)	95-2056687
Autologic, Inc.	94-1595880
Community Residential Centers, Inc.	52-0936321
Jefferson-Adams Corporation	13-2719371
Volt Technical Services, Inc. (N.Y.)	13-5649428
MKUK Games Corporation	13-2770143
Volt Technical Services Corporation	13-2835773
Volt Temporary Services, Inc.	13-2836154
Shaw & Shaw, Inc.	94-2452403

(c) Volt filed a State of New York Corporation Franchise Tax Report for the fiscal year ended October 31, 1980 which calculated tax as the sum of allocated net income and allocated subsidiary capital. The report included a schedule C which listed the following corporations in which it owned more than 50% of the voting stock. The corporations, employer identification numbers and percentages of voting stock were reported as follows:

<u>Corporation</u>	<u>Employer Ident. No.</u>	<u>Percentage of Voting Stock Owned</u>
Volt Tech. Corp.	95-2056687	100.0
Autologic Inc.	94-1595880	88.0
Comm Residential	52-0936321	100.0
Jefferson Adams	13-2719371	100.0
MKUK Games Corp.	13-2270143	100.0
Volt Tech. Corp.	75-1055081	100.0
Volt Temp. Serv.	13-2836154	100.0
Volt Tech. Serv.	13-2835773	100.0
Shaw & Shaw Inc.	94-2452403	100.0
Volt Energy Sys.	94-2627469	100.0
Volt Med Serv.	95-3474390	100.0
DRI Comp. Leasing	13-3026137	100.0
VDR Inc.	13-3025941	100.0
Volt Delta Res.	13-3026138	100.0
Delta Resources	13-3031524	100.0
Volt Electronics	13-3051873	100.0

Volt's New York Corporation Franchise Tax Report included a copy of Volt's

consolidated U.S. Corporation Income Tax Return for the fiscal year ended October 31, 1980.

Volt's Federal return included the following schedule of consolidated subsidiaries:

<u>Name</u>	<u>Employer Identification No.</u>
Volt Technical Corp. (DEL)	75-1055081
Volt Technical Corp. (CAL)	95-2056687
Autologic, Inc.	94-1595880
Community Residential Centers, Inc.	52-0936321
Jefferson-Adams Corporation	13-2719371
Volt Technical Services, Inc. (N.Y.)	13-5649428
MKUK Games Corporation	13-2770143
Volt Technical Services Corp.	13-2835773
Volt Temporary Services, Inc.	13-2836154
Shaw & Shaw, Inc.	94-2452403
Volt Energy Systems, Inc.	94-2627469
Volt Medical Services, Inc.	95-3474390
DRI Computer Leasing, Inc.	13-3026137
Formerly VDI, Inc.	
VDR, Inc.	13-3025941
Volt Delta Resources, Inc.	13-3026138
Delta Resources, Inc.	13-3031524
Volt Electronics Corporation	13-3051873

(d) Volt filed a State of New York Corporation Franchise Tax Report for the fiscal year ended October 31, 1981. The return calculated tax as the sum of allocated capital and allocated subsidiary capital. The report included a schedule C which listed the following corporations in which it owned more than 50% of the voting stock. The corporations, employer identification numbers and percentages of voting stock were reported as follows:

<u>Corporation</u>	<u>Employer Ident. No.</u>	<u>Percentage of Voting Stock Owned</u>
Volt Tech. Corp.	95-2056687	100.0
Autologic Inc.	94-1595880	88.0
Comm Residential	52-0936321	100.0
Jefferson Adams	13-2719371	100.0
MKUK Games Corp.	13-2270143	100.0
Volt Tech. Corp.	75-1055081	100.0
Volt Temp. Serv.	13-2836154	100.0

Volt Tech. Serv.	13-2835773	100.0
Shaw & Shaw Inc.	94-2452403	100.0
Volt Energy Sys.	94-2627469	100.0
Volt Med Serv.	95-3474390	100.0
DRI Comp. Leasing	13-3026137	100.0
VDR Inc.	13-3025941	100.0
Volt Delta Res.	13-3026138	100.0
Delta Resources	13-3031524	100.0
Volt Electronics	13-3051873	100.0

Volt's Federal return included a balance sheet which contained an asset account entitled "Due from Related Companies". According to the balance sheet, the value of the account increased during the fiscal year from \$12,332,993.00 to \$32,880,238.00. The balance sheet also contained an asset account entitled "Investment in Subsidiaries" which increased from the beginning to the end of its fiscal year from \$782,295.00 to \$983,713.00.

Volt's New York franchise tax report included a copy of Volt's consolidated U.S. Corporation Income Tax Return for the fiscal year ended October 31, 1981. Volt's Federal return included the following schedule of consolidated subsidiaries:

<u>Name</u>	<u>Employer Identification No.</u>
Volt Technical Corp. (DEL)	75-1055081
Volt Technical Corp. (CAL)	95-2056687
Autologic, Inc.	94-1595880
Community Residential Centers, Inc.	52-0936321
Jefferson-Adams Corporation	13-2719371
Volt Technical Services, Inc. (N.Y.)	13-5649428
MKUK Games Corporation	13-2770143
Volt Technical Services Corporation	13-2835773
Volt Temporary Services, Inc.	13-2836154
Shaw & Shaw, Inc.	94-2452403
Volt Energy Systems, Inc.	94-2627469
Volt Medical Services, Inc.	95-3474390
DRI Computer Leasing, Inc.	13-3026137
Formerly VDI, Inc.	
VDR, Inc.	13-3025941
Volt Delta Resources, Inc.	13-3026138
Delta Resources, Inc.	13-3031524
Volt Electronics Corporation	13-3051873
Volt Energy Systems (Mass.) Inc.	Number Applied For

In reviewing these reports and the reports of Volt's subsidiaries, the Division of Taxation ("Division") ascertained that, for the fiscal year ended October 31, 1979, Volt excluded from its entire net income \$513,943.00. The Division concluded that this amount was neither interest

nor dividends from a wholly-owned subsidiary. Therefore, the Division found that this amount should be added back to entire net income. For the fiscal years ending October 31, 1980 and October 31, 1981, the Division added back to Volt's entire net income the interest income which it had received from two wholly-owned subsidiaries on the ground that the interest income was received from New York subsidiaries which had taken the corresponding interest expense as a deduction on their corporate franchise tax reports.

The workpapers describe this particular adjustment as follows:

	Fiscal Year Ended		
	October 31, <u>1979</u>	October 31, <u>1980</u>	October 31, <u>1981</u>
Unidentified source	\$513,943.00		
Delta Resources, Inc.		\$60,225.00	\$ 909,460.00
DRI Computer Leasing		1,521.00	422,692.00
Credit		<u>(19,169.00)</u>	<u>(91,757.00)</u>
	<u>\$513,943.00</u>	<u>\$42,577.00</u>	<u>\$1,240,393.00</u>

The Division also added back to Volt's entire net income the interest expense which was deemed to be indirectly attributable to subsidiary capital. This adjustment was based on the Division's use of a formula which was designed to determine the portion of Volt's interest expense which was indirectly attributable to subsidiary capital. The formula used by the Division may be stated as follows:

$$\frac{\text{Investment in subsidiaries}}{\text{Total assets}} \times \frac{\text{Gross Interest Expense}}{\text{Interest indirectly attributable to subsidiary capital}} = \text{Interest Expense}$$

When it performed its analysis, the Division subtracted the amounts directly attributable to subsidiary capital from the average total assets per Volt's balance sheet to calculate adjusted total assets. The investment in subsidiary capital was determined by adding the cost of subsidiary capital from Volt's accountant's workpapers to the amount of advances. The Division determined that the amounts of the advances were \$5,620,325.00, \$3,888,077.00, \$9,081,425.00 and \$23,351,328.00 for the fiscal years ended October 31, 1978, October 31, 1979, October 31, 1980 and October 31, 1981, respectively. The interest expense was obtained from Volt's corporate income tax returns. For the fiscal years ending in 1980 and 1981, the interest expense was reduced because a portion of the proceeds from the indebtedness was not

available for general corporate purposes.

One portion of the audit concerned the tax on subsidiary capital. The Division found that Volt failed to include in its calculation of subsidiary capital the loans from Volt to its subsidiaries and, therefore, it recalculated the tax by adding such loans to the average fair market value of subsidiary capital. The worksheets calculating subsidiary capital use the term "average loans" and do not show any loans for the fiscal years ended October 31, 1978 and October 31, 1979. The Division determined that the average loans from Volt to its subsidiaries were \$280,154.00 for the fiscal year ended October 31, 1980 and \$5,543,937.00 for the fiscal year ended October 31, 1981. In calculating the tax on subsidiary capital, Volt Technical Corp. (CA) and MKUK Games Corp. were included for each of the years in issue. DRI Computer Leasing, Inc. and Volt Delta Resources, Inc. were included for the fiscal years ended October 31, 1980 and October 31, 1981.

The Division issued a series of four notices of deficiency, dated September 17, 1985, to Volt which asserted a deficiency of corporation franchise tax as follows:

<u>Period Ended</u>	<u>Tax</u>	<u>Interest</u>	<u>Total</u>
October 31, 1978	\$ 43,355.00	\$41,178.00	\$ 84,533.00
October 31, 1979	34,019.00	28,656.00	62,675.00
October 31, 1980	4,524.00	3,325.00	7,849.00
October 31, 1981	115,393.00	67,101.00	182,494.00

The notices of deficiency were protested and after a conciliation conference the tax amounts were adjusted as follows:

<u>Fiscal Year Ended</u>	<u>Tax</u>
October 31, 1978	\$ 42,302.00
October 31, 1979	33,253.00
October 31, 1980	1,914.00
October 31, 1981	114,297.00

At the hearing, Volt's vice president and comptroller testified that, in 1981, Volt raised \$30,000,000.00 by the public issuance of 12-1/8% convertible debentures. Said debentures were convertible into the company's common stock. The purpose of the debt offer was to help Volt achieve its planned strategic growth pattern through acquisitions. Volt's comptroller



explained that, immediately upon the closing of the public offering, the funds were invested in Treasury bills, government securities and a very small percentage in corporate debentures. None of the proceeds from the public offering was advanced to its subsidiaries during the fiscal years in issue. According to Volt's comptroller, the level of its advances to its subsidiaries was not affected by the incurrence of the public debt. In 1982 or 1983, a portion of these monies was placed into Volt's general working funds and, when necessary, lent to first-tier or second-tier subsidiaries.

At the hearing, Volt's comptroller also testified that three companies, which were included in the Division's calculation of interest expense indirectly attributable to subsidiary capital, were second-tier subsidiaries. These corporations were Delta Resources, Inc., DRI Computer Leasing, Inc. and Autologic, Inc.

At the time of the hearing, neither the individual who performed the audit nor his supervisor was available due to their retirement from the Department. However, the Division did produce an individual who attempted to explain the audit adjustments. The workpapers prepared by the original auditor are very detailed and contain sufficient narrative to explain the adjustments which are in issue.

#### CONCLUSIONS OF LAW

A. Volt's first argument is that the Division of Taxation's adjustments violate the "spirit" of Matter of F. W. Woolworth Co. v. State Tax Commn. (126 AD2d 876, 877, 510 NYS2d 926, affd 71 NY2d 907, 528 NYS2d 537). According to Volt, the Court in Woolworth sought to prevent a taxpayer from receiving a double benefit. However, it is argued that the Division denied Volt any benefit because of two adjustments which it made -- denial of the interest income exclusion on interest from subsidiaries and requiring Volt to add back the interest expense attributable to alleged second-tier entities.

B. Since the two adjustments are closely related, they will be considered together. Subdivision 9 of section 208 of the Tax Law sets forth the method of computing entire net income. Tax Law § 208.9(a)(1) provides that entire net income shall not include "income, gain

and losses from subsidiary capital...." The exclusion of income from subsidiaries was enacted in order to encourage corporations to locate their headquarters in New York (see, 2 Comeau, Helm and Murphy, New York Tax Service, § 22.61).

Tax Law § 208.9(b) sets forth the exclusions, deductions and credits which may not be considered in the determination of entire net income. This section provides, in pertinent part, as follows:

"(b) Entire net income shall be determined without the exclusion, deduction or credit of:

\* \* \*

(6) in the discretion of the tax commission, any amount of interest directly or indirectly and any other amount directly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital." (Tax Law § 208.9[b][6] [emphasis added].)

The term "subsidiary" is defined by subdivision (3) of section 208 of the Tax Law and provides as follows:

"The term 'subsidiary' means a corporation of which over fifty per cent of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer."

Tax Law § 208(4)(a) defines subsidiary capital, in relevant part, as follows:

"The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries...on which interest is not claimed and deducted by the subsidiary for purposes of taxation under articles nine-a...of this chapter...." (Emphasis added.)

In accordance with Tax Law § 208.9(b)(6) it has been a consistent and long-standing policy of the Division to disallow interest expense attributable to subsidiary capital (see, Matter of World Wide Volkswagen Corp., State Tax Commn., April 30, 1974). The disallowance is imposed in order to prevent a taxpayer from receiving a double tax benefit which would otherwise occur, since section 208.9(a)(1) provides that a taxpayer may exclude income from subsidiary capital (see, Matter of Unimax Corporation, Tax Appeals Tribunal, November 22, 1989, confirmed Matter of Unimax Corporation v. Tax Appeals Tribunal, 165 AD2d 476, 568 NYS2d 164; Matter of F. W. Woolworth Co. v. State Tax Commn., supra).

C. When the foregoing principles are examined, it is clear that the Division properly

required Volt to add back to its entire net income the income which it received from certain subsidiaries. The exclusion of income at issue herein is limited to that income received from subsidiary capital (Tax Law § 208.9[a][1]). The term "subsidiary capital", in turn, excludes interest on indebtedness which is deducted by the subsidiary (Tax Law § 208[a][4]). Therefore, since two subsidiaries deducted the interest expense on their corporate franchise tax reports, the Division properly required Volt to add back the corresponding interest income because, by statutory definition, the income was not received from subsidiary capital.

D. Volt next argues that the Division's indirect attribution of interest expense to subsidiary capital is erroneous because a portion of the interest expense is attributable to second-tier subsidiaries. It is argued that the auditor made no attempt to differentiate between first-tier and second-tier subsidiaries and that the testimony of Volt's witness clearly establishes that a portion of Volt's interest expense was attributable to three second-tier subsidiaries -- Delta Resources, Inc., DRI Computer Leasing, Inc. and Autologic, Inc.

E. The foregoing testimony must be compared to the available documentary evidence. For each of the years in issue, the amount of interest for indirect attribution corresponded with the amount of interest deducted on Volt's U.S. corporation income tax returns. Thus, the first question is whether the reported interest expense included the alleged second-tier subsidiaries.

Each of Volt's Federal returns includes a schedule which lists Volt and its consolidated subsidiaries. An examination of this schedule for each of the years in issue shows that Delta Resources, Inc. and DRI Computer Leasing, Inc. were only included in Volt's consolidated Federal returns for the years 1980 and 1981. Autologic, Inc. was included in Volt's consolidated Federal returns for each of the years in issue. Thus, for the first two years in issue, only Autologic, Inc. needs to be examined.

For each of the years in issue, Volt's New York franchise tax reports included a schedule C entitled "Subsidiary Capital and Allocation". The instructions on the report direct taxpayers to "[i]nclude all corporations, except a DISC, in which you own more than 50% of the voting stock". This instruction corresponds with the previously-quoted statutory definition of

subsidiary capital (Tax Law § 208[4]). An examination of the schedule C's shows that Volt included Autologic, Inc. as a subsidiary for each of the years in issue and listed Delta Resources, Inc. and DRI Computer Leasing, Inc. as subsidiaries for the fiscal years ended October 31, 1980 and October 31, 1981. Thus, there is an unexplained conflict between testimony about events which occurred years earlier and contemporaneously prepared documents. In the absence of any documents or other corroborating evidence to support the testimony, it is concluded that the tax returns are more reliable than the testimony and that Volt has not sustained its burden of proof of establishing that any of the interest which was indirectly attributable to subsidiary capital arose from second-tier subsidiaries.

F. Volt next argues that there are several significant problems with the Division's method of computing the audit adjustment. Initially, Volt argues that the Division computed the value of subsidiary capital in different ways when it calculated the tax on subsidiary capital and when it calculated the tax indirectly attributable to subsidiary capital.

Volt's argument overlooks the fact that the calculations of subsidiary capital were for different purposes and pursuant to different provisions of the Tax Law. The value of subsidiary capital for purposes of the tax on subsidiary capital is based upon the average fair market value of the assets (Tax Law § 210[2]). On the other hand, the value of assets used in calculating the interest expense attributable to subsidiary capital is based on the book value from the taxpayer's balance sheet. Therefore, the values would normally be different. It is noted that, contrary to Volt's suggestion, the two separate calculations of interest indirectly attributable to subsidiary capital in the Division's workpapers did not use different values of subsidiary capital for 1981.

G. Volt argues that the amounts ascribed to average loans in the calculation of subsidiary capital should be the same as the amounts listed as advances on the calculation of interest indirectly attributable to subsidiary capital. This argument is rejected because it fails to take cognizance of the fact that the two calculations are based on different principles.

In general, subsidiary capital is defined as the total of a taxpayer's investment in the shares of stock of its subsidiaries plus the amount of indebtedness owed to the taxpayer by its

subsidiaries on which the interest is not claimed or deducted for purposes of the corporation franchise tax (20 NYCRR 3-6.3[a][1], [2]). In determining subsidiary capital, certain liabilities are required to be deducted (20 NYCRR 3-6.4).

The pertinent regulatory provision states as follows:

"Unless the Tax Commission specifically authorizes to the contrary, each item of subsidiary capital must be reduced by any liabilities of the taxpayer (parent), payable by their terms on demand or not more than one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to that item of subsidiary capital. The reduction will be made, for example, in cases where the liabilities have been incurred in connection with the acquisition or holding of stock or securities of a subsidiary, or in the making of a loan to a subsidiary." (20 NYCRR 3-6.3[b].)

The Division's formula for interest expense indirectly attributable to subsidiary capital is based on the Division's need to calculate that portion of a taxpayer's interest expense which is indirectly attributable to subsidiary capital. As noted earlier, this formula is:

$$\frac{\text{Investment in subsidiaries}}{\text{Total assets}} \times \frac{\text{Gross Interest Expense}}{\text{Interest indirectly attributable to subsidiary capital}} = \text{Interest indirectly attributable to subsidiary capital}$$

The numerator of this fraction was recently described by the Tax Appeals Tribunal in Matter of Unimax Corporation (*supra*). In its decision, the Tax Appeals Tribunal noted that the numerator of the fraction consists of two distinct components: the investment in the stock of the subsidiary and loans and advances between the parent and the subsidiary. The Tax Appeals Tribunal also noted that, in calculating the numerator of the fraction, the Division permitted loans and advances to the parent by a subsidiary to be offset against loans and advances from the parent to such subsidiary.

H. With these principles in mind, it is clear that there is no necessary correlation between those amounts for loans on the subsidiary tax calculation and those amounts designated as advances on the calculation of interest expense indirectly attributable to subsidiary capital calculation. The nature of the liabilities concerned and calculation of those liabilities are separate and distinct. Further, if the amounts set forth in the audit report as loans or advances were erroneous, petitioner should have presented evidence as to what the correct amounts were.

I. Volt maintains that the amounts designated as loans on the Division's calculation of subsidiary capital should be zero because the corporations included in this calculation were all second-tier subsidiaries. This argument is rejected because in each instance where a subsidiary was included in the subsidiary capital computation, that subsidiary was included in Volt's schedule of subsidiary capital on its New York Corporation Franchise Tax Report for the respective fiscal year.

J. Volt submits that the interest which the Division added back to Volt's entire net income was deducted by the subsidiaries in computing their franchise tax liability. Volt submits that the Division violated 20 NYCRR 3-6.3(d) by including this amount in Volt's subsidiary capital.

Volt is correct in its assertion that subsidiary capital does not include an indebtedness on which interest is deducted by the subsidiary in computing New York State franchise tax imposed on subsidiaries under Articles 9-A, 32 or 33 of the Tax Law (20 NYCRR 3-6.3[d]). However, there is no evidence in the record that the loans which the Division included in Volt's subsidiary capital were the same indebtedness which the subsidiaries claimed as interest expense. Therefore, Volt has failed to sustain its burden of proof of establishing that it is entitled to an adjustment on this basis.

K. Volt argues that the interest expense from the debentures should be excluded from the amount of interest which is indirectly attributable to subsidiary capital. This argument is based on the comptroller's testimony that none of the funds from the issuance of the debentures were invested in the subsidiaries. Volt notes that the proceeds from the debentures were to be used for internal growth or for acquisitions. However, since no acquisitions took place during the audit period, the proceeds were invested. Volt also maintains that, during the audit period, loans to subsidiaries were consistent. Therefore, Volt maintains that this case is distinguishable from Matter of F. W. Woolworth Co. v. State Tax Commn. (*supra*) which found it reasonable to conclude, on the facts presented therein, that certain interest expense was indirectly attributable to subsidiary capital. Finally, Volt argues that the subsidiaries did not have a large earnings

base from which the parent could have drawn dividends and that the use of the loan proceeds after the audit period has no bearing on the amount of interest indirectly attributable to subsidiary capital during the audit period.

L. In order to defeat the disallowance of the interest deduction, Volt must establish that the indebtedness was not directly or indirectly attributable to subsidiary capital (Tax Law § 208[9][b][6]; see, Matter of F. W. Woolworth Co. v. State Tax Commn., supra). Factors such as a change in the book value of a parent's investment in its subsidiaries or a change in the amount of advances to a subsidiary may support the conclusion that the borrowing in issue was an element in a parent's decision to increase its investment in its subsidiaries (Matter of F. W. Woolworth Co. v. State Tax Commn., supra).

Here, the balance sheet of Volt's U.S. Corporation Income Tax Return for the fiscal year ended October 31, 1981 reports an asset account entitled "Due from Related Companies" which increased during its fiscal year from \$12,332,993.00 to \$32,880,238.00. The balance sheet reports that another asset account entitled "Investment in Subsidiaries" increased in value from \$782,295.00 to \$983,713.00. In view of the substantial increase in each of these accounts, it was rational for the Division to conclude that there was an inextricable connection between its investments and its financing decisions (see, Matter of F. W. Woolworth Co. v. State Tax Commn., supra). Therefore, Volt has not shown that the Division's disallowance of the interest expense indirectly attributable to subsidiary capital was in error.

M. Volt's last argument is that the audit schedules and workpapers are inconsistent and unreliable. It is alleged that the Division's witness could not explain what had been done and that this reflects on the quality and reliability of the audit.

The audit report and workpapers herein show that a very extensive and thorough audit was conducted. Under these circumstances, it obviously would have been preferable for the individual who conducted the audit to have testified. However, the lack of this testimony does not affect the validity of the audit (see, Matter of Mira Oil Co. v. Chu, 114 AD2d 619, 494 NYS2d 458, lv denied 68 NY2d 602, 505 NYS2d 1026).

The audit report and workpapers are orderly and contain a narrative which is sufficient to show how the tax was calculated. Under these circumstances, any asserted deficiency in the testimonial evidence presented by the Division cannot be imputed to the accuracy of the field audit.

N. Before concluding, it is noted that at the outset of the hearing an issue was raised as to whether the Division properly included short-term advances from Volt to its subsidiaries in the numerator of the fraction used to calculate interest indirectly attributable to subsidiary capital. Since petitioner did not mention this point again in its summation or briefs or explain at any time why this approach was erroneous this argument has been deemed waived.

O. The petition of Volt Information Sciences, Inc. is denied, and the notices of deficiency, as adjusted at conference, are sustained.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE